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Supreme Court of the United States

No. 907.

OCTOBER TERM, 1941.

THE CITIZENS NATIONAL BANK OF KIRKSVILLE, MISSOURI, PETITIONER,

VS.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

PETITIONER'S REPLY BRIEF TO RESPONDENT'S BRIEF IN OPPOSITION.

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Petitioner submits herewith its reply brief to respondent's brief in opposition.

I.

The amounts paid to Frank Baird are deductible as exhaustion or amortization of the terminable interest in the property acquired from him by petitioner.

1. It is believed that an unwarranted conclusion is contained in respondent's summary of the facts as stipu-

lated (Br. 4) wherein it is stated that the Will provided "that in the event of the destruction of the building by fire or tornado Mrs. Belshe should have the right to rebuild, using the insurance money for that purpose, and would thereafter own the property *outright* by paying Frank Baird an amount monthly equal to the net amount he had been realizing as rental of the property" (Italics ours). The Will is included as a part of the stipulation of facts (R. 21-24) which provides in substance the same as the above quoted provision except there is no statement in the Will that the property would thereafter be owned "outright" or otherwise (R. 22). In the body of the stipulation of facts (R. 18) there is contained a statement in substance the same as the above quoted provision, except it states that Mrs. Belshe would thereafter "own the property" by making the above described payments to Frank Baird. Attention is called to this provision, since it is petitioner's contention that Frank Baird has at all times had an interest in the property. The contract whereby petitioner acquired Frank Baird's life interest contains the express provision that his life estate would revert to him in the event the building was destroyed by fire or storm (R. 19). The remainder interest of Mrs. Belshe, which was subsequently acquired by petitioner, including the right to rebuild in the event of such destruction of the property, is expressly charged with the liability for making these payments during the remainder of Frank Baird's life and obviously he would have the right to regain his life interest in the property from the remainderman in the event such payments were not continued; and the remainderman (Petitioner) would in effect be nothing more than a tenant during the remainder of Frank Baird's life, or as long as the payments were continued.

2. The deduction for the payments made to Frank Baird in 1936 as exhaustion or amortization of the cost of his life interest in the property acquired by petitioner

is claimed under the provisions of Section 23 (a) or Section 23 (1) of the Revenue Act of 1936, c. 690, 49 Stat. 1658, 1660, (Pet. 9), and not under Section 23 (a) alone as stated in respondent's brief (Br. 7). Petitioner has never contended that the mere fact the purchase price was being paid in installments altered the nature of the transaction. Even though the payments for a terminable estate constitute capital expenditures they are, nevertheless, deductible from income spread over the life of the estate under the authorities cited by petitioner (Pet. 8-9).

Respondent contends that the circuit court of appeals cases relied on by petitioner (Pet. 8-9) are not in point and states that in each of these cases the taxpayer was the holder of a leasehold estate, while in the instant case petitioner's payments were made toward the acquisition of a fee simple in possession (Br. 7-8). Respondent apparently concedes that otherwise these decisions would be squarely in point, since it is stated that in each of these cases the cost of the leasehold estate was returnable by annual deductions from gross income. As pointed out in the petition for certiorari (Pet. 9) the case of *Davison* v. *Comm.*, 2nd Cir., 60 F. 2d 50, involved a single sum paid for a leasehold and an option to purchase, which the taxpayer exercised, and the portion of the payment that represented the cost of acquiring the leasehold was held to be an exhaustible capital investment, returnable by annual deductions spread over the term of the lease. Even though petitioner subsequently acquired the remainder interest, the payments herein involved were made for only Frank Baird's life estate, which of necessity remained a separate estate, and the decision of the Circuit Court is in direct conflict with these decisions, each of which permitted the identical deduction herein claimed, namely, exhaustion or amortization of the cost of a terminable estate over the life of the estate.

Respondent attempts to show (Br. 8) that there is no conflict with the decision of this Court in the case

of *Duffy* v. *Central R. R. Co.*, 268 U. S. 55, with respect to the claim for a deduction as exhaustion or amortization as contended by petitioner (Pet. 8), but the decision clearly shows that the portion of the cost of the leasehold estate therein involved, consisting of improvements having a life beyond the term of the lease, was allowed as a deduction by annual allowances for exhaustion and supports petitioner's claim to the deduction herein involved.

The Circuit Court held that the payments to Frank Baird come within and are expressly prohibited by Section 23 (a), *Supra* (R. 50-51). The decision of the Circuit Court is, without question, in direct conflict with this Court's definition of the term "or other payments" contained in the last provision of Section 23 (a), *Supra*, in the case of *Duffy* v. *Central R. R. Company, Supra*, as is pointed out in the petition for certiorari (Pet. 7, 8), and respondent does not specifically question petitioner's contention in this respect. It will be noted that petitioner contends there is a conflict with this decision in two respects as referred to in this and the preceding paragraph.

Respondent alleges (Br. 8-9) that petitioner's contentions are contradictory since it contends (Pet. 8) that the provisions contained in the earlier portions of Section 23 (a), *Supra*, do not contain any restrictions as to the deduction claimed and also relies upon the circuit court of appeals cases cited (Pet. 8-9). Respondent's assertion in this respect is not understood and it is submitted that there is obviously no contradiction as to petitioner's contentions. Respondent lastly contends, as to this point (Br. 9), that petitioner's claim must fail because the payments to Baird constitute a capital expenditure and not a business expense. As to this, attention is again called to the authorities relied upon which uniformly hold that payments for a terminable estate constitute capital expenditures deductible over the life of the estate.

II.

The amounts paid to Frank Baird are deductible as annuity payments made in the acquisition of his interest in the property.

All of the factors referred to by respondent (Br. 9-10) in opposition to petitioner's contention that it should also be permitted to deduct the $2,400 paid to Frank Baird in 1936 as expense or loss resulting from the payments of an annuity, are present and apply with equal effect to the determining factors in the case of *Comm.* v. *John C. Moore Corp.*, 42 F. 2d 186 (C. C. A. 2d), upon which petitioner relies (Pet. 11-12) and the same objections were raised by the Commissioner of Internal Revenue in that case, 42 F. 2d, at 187. In that case the taxpayer was not engaged in the commercial writing of annuities but simply acquired property theretofore leased by it agreeing to pay a stipulated sum annually during the life of the owner. Respondent admits (Br. 10) that the language used in the decision in that case is "inconsistent" with the decision of the court below in the instant case but refers to this language as being *"obiter."* Petitioner submits that the language in question is not in fact to be regarded as *obiter*. While the life expectancy of the annuitant in the Moore case had not been reached by the end of the taxable years therein involved, however, in order to determine the amount of the annuity payments allowable for those years as a deduction from income it was necessary to also determine the deductible status of the payments after the life expectancy had been reached and by a determination of the former the latter followed as a matter of course. At the time of the decision in the Moore case the decisions were conflicting, one line of decisions permitted the entire cost of the annuity to be recovered before any tax liability resulted and ignored the life expectancy, while other decisions permitted a portion of the payments to be deducted before the life expectancy was reached.

Respondent cites the case of *Steinbach Kresge Co.* v. *Sturgess*, 33 F. Supp. 897 (D. N. J.). It is not apparent from a careful reading of that decision that the findings of the court in that case would have been any different than in the Moore case had the facts been similar.

As pointed out in the petition for certiorari (Pet. 11-12), the decision of the Circuit Court in the instant case is in every respect in direct conflict with the decision of the court in the Moore Case.

III.

If petitioner is not entitled to deduct the full amount paid to Frank Baird in 1936, it is entitled to deduct as a loss in 1936 that portion ($1,971.44) of the $2,400 that is applicable to the payment for his interest in the building that was demolished in 1923.

In connection with the authorities cited and relied upon by petitioner (Pet. 12-14) in support of its contentions as to this point, respondent asserts (Br. 10-11) that the cases cited are not applicable but does not make any explanation in support thereof except that the case of *Eckert* v. *Burnet*, 283 U. S. 140, involved a loss from the giving of a note and that the decisions in the other cases cited "stemmed" from this case. As pointed out in the petition for certiorari (Pet. 13-14), this Court in a later decision in the case of *Helvering* v. *Price*, 309 U. S. 409, held that the decision in the Eckert case applies and is controlling as to a deduction claimed under a section of the revenue act containing a provision similar to that contained in Section 23 (f) of the Revenue Act of 1936, 49 Stat. 1659, under which the deduction herein is claimed. A reference to the decisions in the cases cited and relied upon by petitioner (Pet. 12) will disclose that they are squarely in point and hold that where the taxpayer is on a cash receipts and disbursements basis that deductions for losses can only be taken in the year or years in which actual payments in cash or its equivalent are made.

There are numerous other decisions holding to the same effect and no decisions have been found and none are cited by respondent holding otherwise. There cannot be the slightest doubt but that the decision of the court below is in direct conflict with the decisions in the cases cited.

Respondent further asserts (Br. 11) "that if any loss was sustained by the taxpayer from demolition of the old bank building it occurred in 1923 and was deductible in that year only," notwithstanding the fact that petitioner filed its return on a cash receipts and disbursements basis (R. 17) and consequently only sustains losses as actual cash payments are made as is uniformly held by all of the authorities. In support of his contention, respondent cites (Br. 11) the cases of *Union Bed & Spring Co.* v. *Comm.*, 39 F. 2d 383 (C. C. A. 7th); *Louis Pitzitz Dry Goods Co.*, 22 B. T. A. 161. Both of these cases involve losses due to voluntary removal or demolition of buildings for which the purchase price had been paid prior to or at the time demolished and it is obvious that the only time the loss in such a case would be allowable would be the year in which demolished irrespective of whether or not the taxpayer was on the accrual or cash receipts and disbursements basis and consequently do not support respondent's contention.

Conclusion.

It is respectfully submitted that the petition for a Writ of Certiorari should be granted.

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